

Message Text

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C O N F I D E N T I A L REYKJAVIK 0480

FOR EUR

E.O. 11652: GDS

TAGS: PFOR IC

SUBJECT: QUARTERLY TRENDS REPORT: ICELAND

REF: REYKJAVIK 1561, DEC. 28, 1973

1. MAJOR PROBLEM IN U.S.-ICELANDIC RELATIONS CONTINUES TO BE THE DISPOSITION OF THE IDF RETENTION ISSUE. LOCAL PARTY POLITICS IS STILL THE DOMINANT FACTOR. THE SITUATION HAS SEESAWED, WITH THE GOOD GUYS ON TOP ONE DAY AND THE BAD GUYS THE NEXT. THE ONLY REAL CHANGE SINCE THE LAST QUARTERLY REPORT IS THAT THE ICELANDIC GOVT HAS FINALLY FORMULATED A NEGOTIATING POSITION ON THE DEFENSE ISSUE FOR THE NEXT ROUND SCHEDULED TO TAKE PLACE IN WASHINGTON APRIL 8 AND 9. THE CABINET MET TO PUT TOGETHER A HORSE AND CAME OUT WITH A CAMEL. NONE OF THE POLITICAL PARTIES INSIDE
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OR OUTSIDE THE GOVT IS HAPPY WITH THE OUTCOME WITH THE EXCEPTION

OF THE COMMUNISTS BECAUSE THE PROPOSALS CALL FOR THE COMPLETE WITHDRAWAL OF THE DEFENSE FORCE EVEN THOUGH A YEAR LATER (MID 1976) THAN THEY HAD DEMANDED. THE PROPOSALS ALSO SET FORTH "CONCESSIONS" TO NATO "IN ORDER TO COMPLY WITH THE OBLIGATIONS OF ICELAND TOWARDS NATO," WHICH GOVT LEADERS ADMIT IN PRIVATE ARE ABSURD. THE GOVT HAS, HOWEVER, LABELED THE PROPOSALS FOR DISCUSSION PURPOSES ONLY AND NOT AN ULTIMATUM TO THE USG. REYKJAVIK TELEGRAMS ON THE IDF RETENTION NEGOTIATIONS TRANSMITTED SINCE MARCH 22 DESCRIBE THE SITUATION FULLY. THE NEXT FEW WEEKS WILL SEE INCREASING AND ACROMOMIOUS DEBATE ON THE BASE RETENTION ISSUE IN ALL STRATA OF ICELANDIC SOCIETY, WITH THE GOVT ON THE DEFENSIVE. USG POLICY IN THE PAST 2 YEARS OF KEEPING THE DIALOGUE GOING WITH THE GOVT, WHILE AT THE SAME TIME STRETCHING OUT THE MOMENT OF DECISION HAS SO FAR PROVED TO BE TO OUR ADVANTAGE. I SEE NO REASON TO CHANGE THIS TACTIC, SINCE IT ALSO SEEMS TO BE THE TACTIC OF THE PRESENT ICELAND GOVT.

2. IN ECONOMIC MATTERS ICELAND IS PLAGUED BY AN EVER-INCREASING RATE OF INFLATION AND A SLOW DECLINE IN CERTAIN KEY EXPORT PRICES. IN 1973 THE COST OF LIVING INDEX ROSE 28.3 PERCENT, WELL ABOUT THE 9 - 12 PERCENT LEVEL ICELAND HAD LEARNED TO LIVE WITH OVER SEVERAL PRECEDING YEARS. A COMBINATION OF HIGH WAGE SETTLEMENTS, CONTINUED LINKAGE OF WAGES TO THE COST-OF-LIVING INDEX, AND SUBSTANTIALLY HIGHER IMPORT COSTS POINT TO INFLATION IN 1974 ON THE ORDER OF AT LEAST 35 - 40 PERCENT WITH WAGES RISING BY AS MUCH AS 60 PERCENT. SO FAR THE GOVERNMENT HAS DONE VIRTUALLY NOTHING TO TACKLE THE PROBLEM, BUT WITH PRICES OF JUST ABOUT EVERYTHING GOING UP 15 - 30 PERCENT IN MARCH ALONE AND WITH FOREIGN EXCHANGE RESERVES DOWN NEARLY A THIRD BY MID-MARCH (ONLY PARTLY DUE TO SEASONAL FACTORS), SOME GOI ACTION MUST BE CONSIDERED IMMINENT. A DEVALUATION IS A NEAR-CERTAINTY ALTHOUGH THERE IS SOME TALK OF AVOIDING THIS BY A FORCED ROLLBACK OF ALL WAGES AND PRICES. THE MOST PRESSING NEED - A SEVERING OF THE LINK BETWEEN WAGES AND THE COST-OF-LIVING INDEX - IS QUITE UNLIKELY GIVEN THE PRESENT WEAK POSITION OF THE GOVERNMENT AND ITS STRONG RELIANCE ON LABOR. PATCHWORK REMEDIES ARE THEREFORE MOST PROBABLE, AND THE RATE OF INFLATION AND GENERAL ECONOMIC UNCERTAINTY CAN BE EXPECTED TO CONTINUE AT AN INCREASING LEVEL.

3. FOR THE PAST SIX MONTHS ICELANDIC POLITICAL LEADERS
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HAVE BEEN PREDICTING THE IMMINENT COLLAPSE OF THE GOVT. THIS MIGHT FINALLY COME TO PASS WITHIN THE NEXT 4 TO 6 WEEKS. THE ECONOMIC CRISIS AND THE DEFENSE ISSUE CRISIS SEEM BEYOND THE CAPABILITY OF THE GOVT TO HANDLE AT THE SAME TIME. SHOULD THE GOVT COLLAPSE, THE DEFENSE ISSUE WILL MOST ASSUREDLY BECOME A DOMINANT ISSUE IN THE ELECTION CAMPAIGN.
IRVING

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